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LL.M. PERSPECTIVE

Consequences of E.U. Airline Deregulation in the Context of the Global Aviation Market

*Moritz Ferdinand Scharpenseel**

I. INTRODUCTION

Aviation, both domestic and international, is an industry that has traditionally been regulated throughout the world.¹ The 1980s, “however, witnessed considerable changes in attitude towards economic regulation[,] [c]hanges which transcended international borders and which covered virtually all aspects of economic activity.”² Furthermore, in January 1993 the

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¹ SEAN D. BARRETT, *FLYING HIGH: AIRLINE PRICES AND EUROPEAN REGULATION* 6 (Adam Smith Institute ed., 1987).

² See Kenneth Button & Dennis Swann, *Aviation policy in Europe*, in *AIRLINE DEREGULATION* 85 (Kenneth Button ed., 1991) (claiming that “[i]n the Western [European] economies the decade was characterized by a withdrawal of the state as privatization and regulatory reforms were carried through”).

European Union ("E.U.") completed its transformation into a single European market.³ The demand of this market, including almost 375 million people and a gross national product exceeding \$7 trillion, makes it the largest domestic market in the world and consequently creates an enormous challenge for the European airline industry with regard to communication, transportation and commerce.⁴

Worldwide, in 1996, 800 airlines with more than 3 million employees carried 1.35 billion passengers and 22.2 billion barrels of cargo.⁵ Through 2005 the expected annual rate of growth will be 5.5% for passenger and 7% for cargo transport. For the E.U., the estimate is 4.5% for passenger and 5% for cargo transport.⁶

Nevertheless, it remains uncertain whether the airline industry will be profitable. For an industry that collectively lost \$15 billion in the first few years of the 1990s, the net profits of all scheduled airlines, which worldwide rose from \$4.5 billion in 1995 to \$8.5 billion in 1997, have brought a welcome change.⁷ Although in the past few years the airlines benefited from rising net profits, "[t]he average consumer is paying 70 percent less per passenger-mile in real terms than 20 years ago, and revenue per seat is declining by an average of 2 percent a year."⁸ Consequently, air transport was subject to some of the most important and dramatic changes in policy and from a very highly regulated industry, it has gradually become more market oriented as both national and international markets have been deregulated.⁹

While airline deregulation first started in the United States ("U.S.") when Congress passed the "Airline Deregulation Act" in 1978,¹⁰ it took

³ See COMMISSION OF THE EUROPEAN COMMUNITIES, COMPLETING THE INTERNAL MARKET: WHITE PAPER FROM THE COMMISSION TO THE EUROPEAN COUNCIL, COM(85)310 final (1985) (observing that the move towards a single European market had implications not simply for trade and commercial policy but also for transport policy within the E.U. and put pressure on the member states to integrate aviation within the overall legal framework of E.U.'s policies).

⁴ RALPH H. FOLSOM, MICHAEL W. GORDON, JOHN A. SPANOGLE, INTERNATIONAL TRADE AND INVESTMENT: IN A NUTSHELL 278 (2000); see also Helmut Gröner, Preface to REGULIERUNG UND WETTBEWERB IM EUROPÄISCHEN LUFTVERKEHR [REGULATION AND COMPETITION IN EUROPEAN AIR TRANSPORT] at v (Helmut Gröner ed., 1989).

⁵ *World Scheduled Airline Traffic Shows Continued Growth in 1996*, ICAO NEWS RELEASE PIO 16/96 (Int'l Civil Aviation Org., Montreal, Canada) Dec. 23, 1996.

⁶ *Growth in Air Traffic to Continue: ICAO Releases Long-Term Forecasts*, ICAO NEWS RELEASE PIO 4/97 (Int'l Civil Aviation Org., Montreal Canada), Mar. 1997.

⁷ *The Sky's the Limit*, ECONOMIST, Mar. 10, 2001, at 3.

⁸ *Id.*

⁹ See GÜNTER KNIEPS, DEREGULIERUNG IM LUFTVERKEHR [DEREGULATION IN AIR TRAFFIC] 6, 1987 (arguing that the purpose of deregulation is to activate the existing competitiveness in a market and thereby to stabilize its industry).

¹⁰ Airline Deregulation Act of 1978, Pub. L. No. 95-504, § 10(a), 92 Stat. 1705, 1713 (1980).

time for the member states of the E.U. to make progress towards liberalization on a community-wide basis.¹¹ At its beginning, liberalization in the airline industry was only possible between pairs of countries.¹² These bilateral agreements “have both resulted in greater flexibility in the types of services offered on the routes involved” and demonstrated that “excessive instability need not arise under freer market conditions.”¹³ The legislative power to deregulate on a community-wide basis was the result of the Single European Act,¹⁴ which the E.U. member states agreed to in 1986.¹⁵

The objective of this article is to show the background of the airline liberalization process in the E.U. and to evaluate its economic effects in context of the global aviation market. To understand the pressures for change and the forms that the changes are taking, it is first necessary to appreciate why market regulation was thought important and how the U.S. deregulated its airline industry. Therefore, Section II of this paper will analyze the different market structures in the U.S. and the E.U. In Section III, the discussion will continue with a consideration of the effects of U.S. airline deregulation. Section IV will give particular attention to the major legislative actions of the E.U. creating new international aviation law. Section V of this paper will examine whether liberalization in Europe has produced identical results to that experienced across the Atlantic. Finally, the implications of the emerging European situation in the wider context of the global aviation market and possible competitive concerns are considered in Section VI.

II. REGULATION OF INTERNATIONAL AVIATION

Regulation of international aviation originated at the Paris Convention of 1919,¹⁶ which accepted that states have sovereign rights over the air space above their territory.¹⁷ This immediately involved national governments in the regulation of the airline industry, which was sought to suppress

¹¹ Robert Espérou, *La libéralisation du transport aérien en Europe (The liberalization of the air transport in Europe)*, REGARDS SUR L'ACTUALITÉ, February 1997, at 7.

¹² Memorandum of the Commission of the European Communities, COM(79)311 final (proposing liberalization on a Community-wide basis and holding the opinion that E.U. law is applicable to bilateral agreements between the member states).

¹³ Button & Swann, *supra* note 2, at 95.

¹⁴ Single European Act, O.J.L 169/1, 2 C.M.L.R. 741 (1987) [hereinafter SEA].

¹⁵ The key feature of the 1986 Single European Act was the commitment to complete the internal market by the end of 1992, Kenneth J. Button & Dennis Swann, *Transatlantic lessons in aviation deregulation: EEC and US experiences*, 37 ANTITRUST BULL. 207, 233 (1992).

¹⁶ See MAREK ZYLICZ, INT'L AIR TRANSPORT LAW 59 (1992).

¹⁷ BARRETT, *supra* note 1, at 7; see also Jürgen Basedow, *Airline Deregulation in the European Community-Its Background, Its Flaws, Its Consequences for E.C.-U.S. Relations*, 13 J.L. & COM., 247, 248 (1994) (noting that “[u]nder international law, the starting point is the territorial sovereignty of each state which extends beyond the surface to the whole of the airspace above.”).

the threat of competition.¹⁸ Regulators' motives for doing so varied from "promoting nationwide air service to stabilizing the fledgling industry and ultimately to protecting the financial interests of individual carriers."¹⁹ Regulatory agencies all over the world were chartered to allow competition while explicitly avoiding "unfair or destructive" competitive practices.²⁰ As with other economic regulation adopted during the period, this mandate reflected the widespread public skepticism of the consequences of unchecked competition that had arisen in the catastrophic economic conditions of the Great Depression.²¹

At the Convention on International Aviation, held in Chicago in 1944,²² the U.S. suggested global open skies for the new civil-aviation industry but, because of the wartime setting, almost all other nations identified aviation with national security and insisted on a regime of national ownership and a system of designated flag carriers.²³

To show the different starting-points of airline deregulation in the U.S. and the E.U., part A of this Section will examine the regulation of U.S. airlines. Part B will then examine the major problems with regard to the regulated E.U. aviation market.

A. Regulation of U.S. Airlines

In the U.S., formal regulation of passenger service dates from the Civil Aeronautics Act passage in 1938.²⁴ This Act established the Civil Aeronautics Agency (reorganized in 1940 to become the Civil Aeronautics Board) and authorized it to award individual routes to carriers, specify the fares and ensure safe airline operating practices.²⁵ The Act provided that an airline is only permitted to serve a route when there was a public interest and when the airline had the capacity to serve the requested route without causing financial harm to any incumbent carrier.²⁶

In this context, the Civil Aeronautics Agency granted permanent authority for existing airlines to serve routes over which they operated at the time of the Act's passage.²⁷ After "grandfathering" the route authority of the 16 airlines operating in 1938, the Civil Aeronautic Board (hereinafter

¹⁸ Donald Pickrell, *The regulation and deregulation of U.S. airlines*, in AIRLINE DEREGULATION 5, 6 (Kenneth Button ed., 1991).

¹⁹ *Id.* at 5.

²⁰ KNEIPS, *supra* note 9, at 27.

²¹ Pickrell, *supra* note 18, at 6.

²² Convention on International Civil Aviation, December 7, 1944, ICAO Doc. 7300/6 art.1.

²³ *Opening wider, A Survey of Air Travel*, ECONOMIST, March 10, 2001, at 7.

²⁴ Civil Aeronautic Act of 1938, Pub. L. No. 75-706, §2, 52 Stat. 973, 980 (1938).

²⁵ *Id.*

²⁶ Pickrell, *supra* note 18, at 6.

²⁷ *Id.*

the “Board”), despite a 14% annual rate of growth in the airline industry, precluded entry into service by new carriers.²⁸ While most of its grants of new route authority were apparently intended to strengthen financially weak carriers by authorizing them to carry profitable traffic, even this “leveling” policy was insufficient to prevent consolidation of the industry from its original sixteen members to eleven that existed when the Board began to deregulate the industry.²⁹

In addition, the Board specified the fares, considering the public interest on low fares as well as the profitability of the airlines and subsidized local airline service connecting small communities with the cities served by the original trunk carriers.³⁰ Consequently, there was no price competition between the airlines but instead competition on quality and service.³¹ Despite these efforts to restrain competition, the industry grew extremely rapidly in the postwar era, carrying well over ten times as many passengers during 1970 as it had 20 years earlier.³² This growth was fuelled by the sustained economic growth the U.S. experienced during the postwar period, coupled with the rapid pace of innovation in aircraft design, which reduced carriers’ cost sharply and thus allowed the Board to maintain stable fares for almost two decades.³³

B. The European System of Regulation

Until the passage of the “Single European Act” in 1986, one of the major problems with respect to E.U. aviation was that no single market for transport services existed.³⁴ First, aviation itself can be divided into sectors providing trunk, commuter, domestic and intercontinental services.³⁵ Second, geographical factors divide aviation markets across the continent.³⁶ In addition, the E.U. member states, each with its own approach to domestic and international aviation policy, continued to exercise total sovereignty over the control of their airspace.³⁷ Consequently, there were almost 200

²⁸ KNEIPS, *supra* note 9, at 28 (claiming that the Civil Aeronautic Board refused all 79 petitions for new service between 1950 and 1974 and granted only 10 percent of the petitions for new services of already established airlines between 1965 and 1978).

²⁹ Pickrell, *supra* note 18, at 7.

³⁰ PAUL S. DEMPSEY & ANDREW R. GOETZ, AIRLINE DEREGULATION AND LAISSEZ-FAIRE MYTHOLOGY 174 (1992).

³¹ KNEIPS, *supra* note 9, at 29.

³² Pickrell, *supra* note 18, at 7.

³³ *See id.* (noting that fares remained virtually unchanged in actual dollars between 1950 and 1970, and actually declined by almost 50 percent in real or inflation adjusted terms).

³⁴ *See supra* text accompanying note 3.

³⁵ Button & Swann, *supra* note 2, at 90.

³⁶ *Id.*

³⁷ Basedow, *supra* note 17, at 248 (noting that European air transportation was “international in nature and therefore governed, in absence of E.U. legislation, by the rules of public international law”); *see also supra* text accompanying note 17.

bilateral agreements³⁸ providing air transport services between the European countries and granting each other some of the eight "freedoms of the air."³⁹ The Chicago Convention of 1944⁴⁰ reached agreement on the first (the right to fly over another country's territory) and the second (the right of an airline to make a technical landing to, for example refuel, but not to pick up passengers) freedom of the air.⁴¹ The third, fourth and fifth freedoms are called commercial freedoms and were more or less granted to the other member states of the E.U. through bilateral agreements.⁴² The third freedom relates to the right of an airline from a foreign country to put down passengers, the fourth freedom allows airlines from foreign countries to pick up passengers and the fifth freedom relates to the right of an airline neither registered in the country of departure, nor in the country of destination to carry passengers between them.⁴³ In international practice, combinations of the third, fourth and fifth freedom rights are also granted in bilateral agreements and therefore eight such freedoms of air can be identified.⁴⁴

As a result of the inability to reach agreements on a multilateral basis, a system of very rigid sub markets emerged in European air transport with major routes generally being shared between the national carriers of the countries concerned.⁴⁵ Fares normally had to be agreed upon both countries involved and, in most instances, the capacity offered by each country was limited to 50% with revenue-share pools.⁴⁶

The general view of the situation prevailing at the beginning of the 1980s is well summarized by the *House of Lords Select Committee on the European Communities*, which claims that the main consequence of this

³⁸ See Commission of the European Communities (1992) Air Transport Relations with third countries: Communication from the Commission to the Council, COM(92)434 final at 10; see also Button & Swann, *supra* note 2, at 91 (observing that member states of the European Union maintain about 60 to 70 agreements each and the overall estimate of the number of bilateral air services agreements worldwide is as high as 3000).

³⁹ See Basedow, *supra* note 17, at 248 (claiming that "sovereignty entitles a state to grant or reject the ability of a foreign airline to carry out certain operations on the surface or in the airspace" and that eight such "freedoms of the air" can be identified).

⁴⁰ Convention on International Civil Aviation, December 7, 1944, ICAO Doc. 7300/6 art. I.

⁴¹ Peter Wolf, *Die Grundregeln des Wettbewerbs im Flugverkehr [The Basic Rules of Competition in Aviation]* in REGULIERUNG UND WETTBEWERB IM EUROPÄISCHEN LUFTVERKEHR [REGULATION AND COMPETITION IN EUROPEAN AIR TRANSPORT], *supra* note 3, at 12.

⁴² SVEN RECKEWERTH, ZUSAMMENARBEIT DER LUFTVERKEHRSGESELLSCHAFTEN NACH EUROPÄISCHEM UND U.S. - AMERIKANISCHEM RECHT [COOPERATION BETWEEN AIRLINES IN EUROPEAN AND U.S.-AMERICAN LAW], at 43 (1993).

⁴³ *Id.*

⁴⁴ Emmanuel Duret, *Evolution des statuts et des activités des aéroports dans le cadre de la déréglementation de Bruxelles*, 381 TRANSPORTS 41, 44 (1997).

⁴⁵ Button & Swann, *supra* note 2, at 90.

⁴⁶ Wolf, *supra* note 41, at 12.

system for allocating routes, fixing fares and pooling revenue was the virtual elimination of competition in fares on scheduled services.⁴⁷

III. DEREGULATION AND ITS EFFECTS IN THE U.S.

As a result of increased skepticism towards regulation, in 1975 the Civil Aeronautic Board authorized new competition on a number of routes for the first time since 1970, and allowed charter carriers to operate low-fare service in direct competition with regulated carriers.⁴⁸ In response to the threat of increased competition from charter carriers and low fare scheduled airlines, American Airlines applied, and was granted, authority to offer discounts of up to 45% on fares.⁴⁹ Emboldened by the results of this experiment, the U.S. Congress enacted the Airline Deregulation Act in October 1978.⁵⁰ The Act terminated the Board's jurisdiction over carriers' route networks in three years and phased out its authority to set fares over a five-year period.⁵¹

The U.S. airline industry experienced rapid transformation after the enactment of the Airline Deregulation Act. This transformation included operational and marketing advantages associated with large hub-and-spoke systems, continuing growth in the demand for intercity travel, and sharp fluctuations in the costs of important inputs used by air carriers.⁵² Certainly the most pronounced effect of deregulation was the decrease of prices for air travel.⁵³ Competition in the airline sector resulted in an average fare decline of 40% in real terms on all routes compared to regulated fares until the enactment of formal deregulation.⁵⁴ By 1986 the average fare per passenger mile in the U.S. was 25% lower than regulated fares per passenger mile in the E.U.

⁴⁷ Button & Swann, *supra* note 2, at 93.

⁴⁸ Pickrell, *supra* note 18, at 8.

⁴⁹ *See id.* at 9 (noting that in the following year the Board allowed carriers to reduce fares by as much as 70 percent and permitted all applicants seeking a new route to simultaneously begin serving it).

⁵⁰ Airline Deregulation Act of 1978, Pub. L. No. 95-504, § 10(a), 92 Stat. 1713 (1980) (codifying fare flexibility and liberal route award policy).

⁵¹ *Luftfahrt Wirrwarr in Stufen [Air Traffic Confusion in Steps]* WIRTSCHAFTSWOCHE [WEEKLY ECONOMIST] 32, February 1, 1985. *See also* Pickrell, *supra* note 18, at 9 (noting that Congress transferred the Board's remaining jurisdiction over airline mergers, consumer complaints and other matters to the Department of Transportation, which transferred the authority over airline mergers to the Department of Justice in 1988).

⁵² *Id.* at 10.

⁵³ *Id.* at 29.

⁵⁴ *Fixing America's airlines*, ECONOMIST, March 10, 2001, at 21; *see also* Steven Morrison & Clifford Winston, *The Dynamics of Airline Pricing and Competition*, 80 AM. ECON. REV., 389, 390 (1990) (observing that "[deregulated fares amounted] to an average annual saving to travellers of roughly \$6 billion").

Table 1: Airfares in the U.S. and the E.U. in June 1986⁵⁵

Distance interval (miles)	Average fare per passenger mile in the E. U. (in U.S. \$)	Average fare per passenger mile in the U.S. (in U.S. \$)
under 250	.55-.65	.32-.34
250-500	.50	.10-.22
500-600	.52	.15
600-800	.38	.24
800-900	.40	.15
900-1000	.46	.12
1000-1500	.46	.11
1500-2000	.34	.11

Another important “development in the U.S. airline industry during the first decade of its deregulated operation has been the transition of individual carriers domestic route systems toward hub-and-spoke configurations” designed to enhance revenues at the expense of competitors.⁵⁶ After the enactment of the Airline Deregulation Act, trunk and local carriers were able to develop route hubs, and in 1996, each carrier had begun to develop one or more major route hubs at large, strategically situated airports.⁵⁷ “In addition, ... each carrier has also attempted to integrate into its route network service to small communities in the immediately surrounding area that are too small to support acceptably frequent flights using its own jet aircraft.”⁵⁸

Soon after passage of the 1978 Deregulation Act, many formerly local service airlines grew quickly and presented real competition. By 1984, the number of airlines competing in national or regional markets had nearly doubled from the nineteen that had been in operation immediately prior to deregulation.⁵⁹ But in the openly competitive environment fostered by deregulation, some airlines have sought to realize these economies by merger

⁵⁵ BARRETT, *supra* note 1, at 2.

⁵⁶ See Pickrell, *supra* note 18, at 20 (noting that “the U.S. pre-deregulation route network consisted of long-haul routes connecting major cities served by trunk carriers together with localized networks connecting smaller cities”).

⁵⁷ Carrier dominance at selected airports in 1996: Delta held 74.02 percent of all slots in Atlanta, United 47.06 percent in Chicago (O’Hare), Delta 92.49 percent in Cincinnati, American 63.5 percent in Dallas, United 69.95 percent in Denver, Northwest 78.62 percent in Detroit, Continental 77.19 percent in Houston, American 63.76 percent in Miami, Northwest 84.45 percent in Minneapolis, U.S. Airways 59.17 percent in Philadelphia and 89.61 percent in Pittsburgh, Trans World Airlines 67.45 percent in St Louis and United 59.76 percent in San Francisco, Salomon Brothers, TRAVEL WEEKLY, November 28, 1996, *quoted in* Ady Milman, *The U.S. Airline Industry*, 3 TRAVEL & TOURISM ANALYST, 4, 9 (1997).

⁵⁸ Pickrell, *supra* note 18, at 22 (claiming that through joint marketing agreements with regional airlines operating in the areas surrounding their route hubs, major carriers have sought to incorporate connecting flights to these small communities into the networks of service they can offer through their hub cities).

⁵⁹ *Id.* at 17.

or acquisition, rather than by internal growth.⁶⁰ Thus, during the 1980s, the airline industry experienced massive consolidation and in the period between 1978 and 1988 alone, there were fifty-one airline mergers and acquisitions.⁶¹ In 1995, the six largest U.S. airlines held a market share close to 82.7%.⁶²

The experience of the U.S. in liberalizing its domestic aviation industry demonstrated that the preceding period of extensive market regulation had stifled the natural development of the market by leading to extensive fares, inefficiency and limited consumer choice. In particular, regulation impeded the natural growth of hub-and-spoke operations. Consequently, economies of density and economies of scope could not be fully exploited. In summary, U.S. passenger boardings went up from 250 million in 1978 to 670 million in 2000, and the average fare was 40% lower in real terms.⁶³ Inevitably, the U.S. experience and its result in lower fares attracted the attention of Europeans. The *House of Lords Select Committee on the European Communities* criticized the differences in fares between the U.S. and the E.U. stating that the interests of European consumers seem to be sacrificed to the prestige of flag carrying national airlines and the protected environment in which they operate.⁶⁴

IV. AIRLINE LIBERALIZATION PROCESS IN THE EUROPEAN UNION

To understand the legal bases of the airline liberalization process in the E.U., this Section will first examine the legal framework of the E.U. and consider the role of the different E.U. institutions with respect to the issue

⁶⁰ See *id.* at 20 (arguing that many financially troubled airlines held valuable assets (for example aircraft, takeoff and landing slots at capacity controlled airports) that made them attractive takeover targets for other airlines).

⁶¹ See Barry E. Hawk, *Airline Deregulation After Ten Years: A Need for Vigorous Antitrust Enforcement and Intergovernmental Agreements*, 34 ANTITRUST BULL. 267, 276 (1989) quoted in Jeff Mosteller, *Comment: The Current And Future Climate Of Airline Consolidation: The Possible Impact Of An Alliance Of Two Large Airlines And An Examination Of The Proposed American Airlines-British Airways Alliance*, 64 J. AIR L. & COM. 575, 578 (1999).

⁶² Bulletin de la Kredietbank, *La liberalisation du transport aerien*, November 1996, PROBLÈMES ÉCONOMIQUES 22, March 26, 1997; see also Greg Schneider, *Airline Mergers Worry Senators*, WASHINGTON POST, June 15, 2000, at E01 (pointing out that according to Senators Mike DeWine (R-Ohio) and Herb Kohl (D-Wis.) the consolidation of the U.S. aviation market that is likely to follow the proposed United-U.S. Airways merger could leave the industry with as few as three major airlines). In July 2001 the U.S. Department of Justice blocked the proposed combination, citing fears that it would "reduce competition, raise fares and harm consumers throughout the United States." Jim McKay, *U.S. Airways-United Merger Dead*, PITTSBURGH POST GAZETTE, July 28, 2001. The Justice Department's position is also likely to chill further speculation of mergers among other big airlines. See Jayne O'Donnell, *United, U.S. Airways Call Off Merger*, USA TODAY, July 27, 2001.

⁶³ *Fixing America's airlines*, *supra* note 54, at 21.

⁶⁴ House of Lords Select Committee on the European Communities, *quoted in* Botton & Swann, *supra* note 2, at 93.

of liberalization. Part B will then analyze the application of the treaty establishing European Community ("EC Treaty") to a common air transport policy and part C will examine the three legislative liberalization packages which replaced the bilateral agreement system within the E.U.

A. The Legal Framework of the European Union

The E.U. is a supranational legal regime with its own legislative, administrative, treaty-making and judicial procedures.⁶⁵ On November 1, 1993, the Treaty on European Union⁶⁶ became operational and the tasks of the E.U. thereafter included the creation of an economic and monetary union with emphasis on price stability.⁶⁷ Technically, the E.U. consists of three treaties⁶⁸ by the member states that establish three communities and several amendments.⁶⁹ In several important sectors the member states have surrendered substantial sovereignty to the three communities that now have the power to adopt regulations being directly applicable in all member states.⁷⁰ E.U. law has replaced national law in many areas and the E.U. legal system operates as an umbrella over the legal systems of the member states.⁷¹

The three founding treaties established four branches of government.⁷² The European Commission (the "Commission") constitutes what the E.U. members refer to as the authority enforcement agency. Besides legislative and executive functions, the Commission has the duty to ensure that business transactions are conducted in conformity with the relevant provisions of the treaties.⁷³ The Commission generally seeks to implement substantial

⁶⁵ FOLSOM, GORDON & SPANOGLE, *supra* note 4, at 275.

⁶⁶ TREATY ON EUROPEAN UNION, February 7, 1992, O.J.(C 224) 1 (1992) [hereinafter TEU] *as amended by* TREATY OF AMSTERDAM, October 2, 1997 O.J. (C 340) 1 (1997).

⁶⁷ FOLSOM, GORDON & SPANOGLE, *supra* note 4, at 280.

⁶⁸ TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [hereinafter EEC TREATY]; TREATY ESTABLISHING THE EUROPEAN COAL AND STEEL COMMUNITY [hereinafter ECSC TREATY]; TREATY ESTABLISHING THE EUROPEAN ATOMIC ENERGY COMMUNITY [hereinafter EURATOM TREATY]. Under Article G(1) of the TEU *as amended by* TREATY OF AMSTERDAM, the former European Economic Community is now called the European Community.

⁶⁹ Entscheidung des Bundesverfassungsgerichts [BverfG] [Federal Constitutional Court] 2134/92, 439 (F.R.G.) (holding in its judgment of October 12, 1993 that "the treaties establish an association of States for creating an ever-closer union among the peoples organized into states of Europe, not a state based upon a single European nation").

⁷⁰ In contrast to "regulations", "decisions" are only binding for the specific addressee and "directives" are only indirectly applicable through the implementation of the member states (see Article 249 of the Treaty establishing the European Community, Nov. 10, 1997, O.J. (C 340) 3 (1997) [hereinafter EC TREATY]).

⁷¹ FOLSOM, GORDON & SPANOGLE, *supra* note 4, at 280.

⁷² Article 7 of the ECSC Treaty; Articles 189, 202, 211, 220 of the EC Treaty; Articles 107, 115, 124, 136 of the Euratom Treaty.

⁷³ The Commission has the power to render opinions and issue recommendations to the Council and was also granted the power to investigate alleged competition infringements by

liberalization in the most heavily regulated areas and even threatens to use all of its powers to see its initiatives implemented.⁷⁴

“The second branch of the government is the Council of Ministers (the “Council”), which is the primary legislative body in the E.U. and is responsible for carrying out the objectives of the treaties.”⁷⁵ “The Council does not render a directive or issue a regulation without either a recommendation or an advisory opinion from the Commission or the European Parliament.”⁷⁶

The third branch, the European Parliament, historically played an advisory role, but the Treaty of Amsterdam⁷⁷ significantly extended Parliament’s co-decisional legislative powers.⁷⁸ In contrast to the Commission, the Parliament advocated a “go-slow” approach with respect to the issue of airline liberalization and recommended allowing member states to delay the implementation of liberalization measures up to fourteen years.⁷⁹

The fourth governmental branch, the European Court of Justice, is responsible for the interpretation and application of the EC Treaty.⁸⁰ It rules on the application of the treaty provisions and also had to decide whether the EC Treaty’s competition rules apply to aviation.⁸¹

With regard to the executive function, the national authorities generally implement Community law. In some limited areas the Commission and the Council perform executive functions themselves.⁸² Only where E.U. institutions are vested with genuine legislative or executive power must the

Article 85(1) of the EC Treaty. PAUL S. DEMPSEY, LAW AND FOREIGN POLICY IN INTERNATIONAL AVIATION 97 (1987).

⁷⁴ See *id.* at 101 (the Council of Ministers, discussed in the next paragraph, observes the Commission’s strategy in achieving progress towards the development of a common air transport policy within the Community).

⁷⁵ See *id.* at 98 (the Council is comprised of representatives from the various member states who theoretically act in accordance with the instructions given to them by their respective member governments).

⁷⁶ See *id.* (the European Parliament consists of elected representatives of the citizens of their respective states).

⁷⁷ Treaty of Amsterdam, October 2, 1997 O.J. (C 340) 1 (1997).

⁷⁸ FOLSOM, GORDON & SPANOGLE, *supra* note 4, at 281; see also PAOLO MENGOZZI, EUROPEAN COMMUNITY LAW FROM COMMON MARKET TO EUROPEAN UNION 302, 1992 (arguing that even the mechanisms introduced by the Treaty of Amsterdam do not provide for a true two-chamber legislative system consisting of two equal Houses).

⁷⁹ DEMPSEY, *supra* note 73, 98 (1987).

⁸⁰ FOLSOM, GORDON & SPANOGLE, *supra* note 4, at 290.

⁸¹ Specifically at issue was whether the French government’s prohibition of the sale of airline tickets below a floor constitutes a violation of the provisions in the EEC TREATY, which require the free movements of goods among the member states, Joined Cases 209-213/84, *Ministre Public v. Asjes*, 1986 E.C.R. 1425; see *infra* Section IV, Part B.

⁸² Thus, arts. 81 through 86 of the EC Treaty and Council Regulation (1968) 17/62, J.O. (C75) 3 (which organizes the procedures for the enforcement of the EEC antitrust rules) endow the Commission with the necessary executive powers, Heinrich Kirschner, *The Framework of the European Union under the treaty of Maastricht*, 13 J.L. & COM. 233, 238 (1994).

Court of Justice enforce Community law. In other fields national authorities applying Community law remain subject to the jurisdiction of their national courts.⁸³

B. Application of the EC Treaty to Aviation

The absence of air transport regulation in the EC Treaty may be explained by the close proximity of the six founding states.⁸⁴ While Articles 70 and 71 of the EC Treaty mandate a common transport policy, Article 80(1) of the EC Treaty expressly confines the scope of the provisions to transportation by rail, road and inland waterway. Under Article 80(2) of the EC Treaty the Council decides whether these provisions may be applied to sea and air transportation.⁸⁵ This statute raised doubts as to whether shipping and aviation were covered by the EC Treaty at all.⁸⁶ But a succession of judgments by the Court of Justice between 1974 and 1986 made it clear that other Articles of the EC Treaty did apply to aviation.⁸⁷ After the *Nouvelles Frontières* decision,⁸⁸ Europe's national carriers saw that their price cartel was in jeopardy and attempted to convince their respective national governments, and the Commission, to enact a block exemption for the aviation market from E.U. competition regulations.⁸⁹ In order to acquire a block exemption for their carriers under Article 85(3) of the EC Treaty, the member states had to pay a political price in terms of further secession of sovereignty rights in aviation matters to the Community. This has been interpreted as their final approval to a deregulation of the European aviation market.⁹⁰

⁸³ *Id.*

⁸⁴ The six founding states of the European Community are Belgium, France, Germany, Italy, Luxembourg and the Netherlands, Basedow, *supra* note 17, at 251.

⁸⁵ Article 80 (2) of the EC TREATY requires a right of each member state to veto any measure in shipping or aviation matters.

⁸⁶ JACQUES NAVEAU, *L'EUROPE ET LE TRANSPORT AERIEN* 224 (1983).

⁸⁷ Case 167/73, *Commission of the European Communities v. French Republic*, 1974 E.C.R. 359 [1974] (holding that the obligation under Article 2 of the EC TREATY to establish a common market refers to the whole of the economic activities in the Community); Joined Cases 209-213/84, *Ministre Public v. Asjes*, 1986 E.C.R. 1425 [1986] (hereinafter *Nouvelles Frontières*) (holding that civil aviation, including the tariff system decided upon IATA, is subject to the competition rules of Articles 85 and 86 of the EC Treaty (as in effect 1986 (now Articles 81 and 82)).

⁸⁸ *Id.*

⁸⁹ Basedow, *supra* note 17, at 253.

⁹⁰ *Id.* With respect to the different criteria of Article 81(3) of the EC Treaty, see ULRICH GEERS, *DIE GRUPPENFREISTELLUNG IM EG-KARTELLRECHT* [THE GROUP EXCEPTION IN EC-ANTITRUST LAW], 36-39 (2000).

C. E.U. Air Transport Liberalization

Given the existence of over 200 bilateral agreements between the E.U. member states and the political compromise necessary to agree on deregulation rules, the measures, which were to be adopted for integration, could not replace the existing treaties altogether.⁹¹ The Community took its first step into the field of scheduled air services regulation in 1987 by enacting the first air transport liberalization package which included four legislative acts.⁹² Two Council Regulations discussed the application of competition rules to air transport.⁹³ Furthermore, a Council decision eliminated capacity limitations between the airlines.⁹⁴ Most importantly, however, Community Directive 87/601 EEC set forth criteria and time limitations for the approval by national agencies of tariff applications made by the airlines.⁹⁵ Consequently, this Directive increased the predictability and international uniformity of administrative decisions and created so-called “zones of flexibility.”⁹⁶

This package, along with the second liberalization package, which entered into force in 1990, did not set up a system of airline licensing and market access, but merely loosened the constraints of the bilateral agreements between member states.⁹⁷ Most significant seems to be Regulation 2342/90 from 1990, which enlarged the “zones of flexibility.”⁹⁸ In contrast, discount and deep discount fares could be fixed within a range of 80% to 94% and 30% to 79% of the reference fare.⁹⁹ The introduction and gradual extension of such zones of price freedom were shaped by the “zones of reasonableness”, also a characteristic of the transition period in the early days of American airline deregulation.¹⁰⁰

Only the third European air transport liberalization package of 1993 replaced the bilateral agreement system with a multilateral system within

⁹¹ *Id.*

⁹² Romina Polley, *Defense Strategies of National Carriers*, 23 *FORDHAM INT'L L.J.* 170, 172 (2000).

⁹³ Council Regulation 3975/87, 1987 O.J. (L 374) 1; Council Regulation 3976/87, 1987 O.J.(L 374) 9.

⁹⁴ Council Decision 87/602, 1987 O.J. (L 374) 19.

⁹⁵ Council Directive 87/601, 1987 O.J. (L 374) 12.

⁹⁶ See Basedow, *supra* note 17, at 257 (noting that “If airlines applied for tariffs that were fixed between the lower and upper margins, their applications could not be dismissed”).

⁹⁷ Council Regulation 2342/90, 1990 O.J. (L 217) 1 (concerning airfares); Council Regulation 2343/90, 1990 O.J. (L 217) 8 (discussing market access); Council Regulation 2344/90, 1990 O.J. (L 217) 15 (regarding application of the EC Treaty to certain categories of agreements and concerted practices).

⁹⁸ See Council Regulation 2342/90, *supra* note 97, at 1 (interpreting an airline’s filed economy class fare as a tariff of reference allowing price cuts and a rise of five percent in both directions for regular fares).

⁹⁹ Council Regulation 2342/90, *supra* note 97, at 1.

¹⁰⁰ Basedow, *supra* note 17, at 257.

the European Union.¹⁰¹ The third package essentially consisted of three Council regulations: one on the licensing of air carriers,¹⁰² one on market access,¹⁰³ and one on fares and rates.¹⁰⁴ Under the air carrier licensing regulation, licenses are still granted by national authorities.¹⁰⁵ However, they are now subject to a set of common rules for air operator's licensing and airlines in all member states and are therefore licensed under similar conditions.¹⁰⁶ These conditions include the establishment of the airline in the licensing member state, the majority control by nationals of member states, the financial viability of the company, insurance to cover liability in the event of accidents, and an air operator's certificate giving evidence of the company's aeronautical fitness.¹⁰⁷ "The licensing of an airline does not provide, in itself, free access to all route markets." While previous law in many member states provided for tight administrative control of market access under a test of public convenience and necessity, the Community has lowered entry barriers on interregional air services and compelled member states to accept multiple designations.¹⁰⁸ In addition, capacity sharing was altogether terminated and the fifth freedom rights were gradually introduced within the E.U.¹⁰⁹ As a result of these measures, most entry barriers were removed and European airlines have access to all air transport routes within the Community, including cabotage.¹¹⁰

In summary, since January 1, 1993 airlines in all E.U. member states are licensed under similar conditions, entry barriers have been lifted to the extent that market access is essentially free and rate making in intracommunity air transport is now unrestricted.

V. EFFECTS OF THE E.U. DEREGULATION

This Section will assess whether European deregulation has been successful so far. Part A will discuss whether there are still obstacles to liberalization within the E.U. Part B will then examine the Commission's power towards the continued application of bilateral air transport agreements between E.U. member states and third countries.

¹⁰¹ Polley, *supra* note 92, at 173.

¹⁰² Council Regulation 2407/92, 1992 O.J. (L 240) 1.

¹⁰³ Council Regulation 2408/92, 1992 O.J. (L 240) 8.

¹⁰⁴ Council Regulation 2409/92, 1992 O.J. (L 240) 15.

¹⁰⁵ Council Regulation 2407/92, *supra* note 102, at 1.

¹⁰⁶ Polley, *supra* note 92, at 173.

¹⁰⁷ Council Regulation 2407/92, *supra* note 95, at art. 4,5,7 and 9.

¹⁰⁸ Basedow, *supra* note 17, at 256; *see also* Polley, *supra* note 92, at 173 (claiming that the common air carrier license system does not apply to air traffic between the E.U. member states and third countries where bilateral air service agreements still apply).

¹⁰⁹ Council Regulation 2408/92, *supra* note 103, at 8.

¹¹⁰ *See* Polley, *supra* note 92, at 174-5 (noting that in April 1997, cargo was liberalized as the last of the implementation of a single aviation market in the E.U.).

In general, liberalization in the E.U. has not led to dramatic changes, like those in the U.S., following deregulation of air transport. Nevertheless, there were notable changes following liberalization.¹¹¹ First, there was above average total growth in air transport in the E.U., particularly in the light of the fact that part of the liberalization process was during an economic recession.¹¹² Second, the number of routes operated in the E.U. increased from 490 in 1992, to 520 in 1996, primarily because of the introduction of new non-stop connections of former charter operators that took up scheduled services.¹¹³ With respect to the creation of new airlines, market dynamics have been most visible. Over three years after the implementation of the third aviation package of 1993, eighty licenses have been granted and eighty companies were created, while sixty have disappeared.¹¹⁴ As far as airfares are concerned, the impact of liberalization is still difficult to assess, but Table 2¹¹⁵ shows that on routes where two or more airlines were operating in 1996, airfares have generally been much lower, than on routes without competition.

Table 2: Airfares on E.U. Routes With Competition in 1996

Competition routes in km	Airfares for Business Class
London–Amsterdam (374 km)	£ 230
London- Frankfurt (634 km)	£ 294
London – Zurich (723 km)	£ 306
London – Nice (1032 km)	£ 413
London – Palma (1347 km)	£ 330

Table 3: Airfares on E.U. Routes Without Competition in 1996

Non-competition routes in km	Airfares for Business Class
Frankfurt–Amsterdam (364km)	£ 377
London–Hamburg (718 km)	£ 442
London – Geneva (746 km)	£ 366
Paris – Madrid (1043 km)	£ 722
Madrid – Rome (1338 km)	£ 708

¹¹¹ *Id.* at 175.

¹¹² Impact of the Third Package of Air Transport Liberalization Measures, COM (96)514 final at 3. Overall traffic increased by 8.1 percent in 1994 (the first year after the implementation of the third liberalization package), the biggest rise for 15 years (leaving aside the 9.1 percent following the drop in traffic recorded in 1991 during the Gulf War); this trend continued in 1995 with growth reaching 6.1 percent. *Id.* at 20.

¹¹³ Polley, *supra* note 92, at 175. In 1996, 30 percent of the Community routes were served by two operators, 6 percent by three operators or more, and 64 percent of the routes were still operated by monopolies, *id.*

¹¹⁴ Polley, *supra* note 92, at 175.

¹¹⁵ British Midland, *Clearing the flight path for competition*, June 1996, quoted in Barry Seal, Memorandum of the European Parliament regarding COM (96) 514 final, January 21, 1998, at 11.

In addition, an impressive number of promotional fares have developed and the share of the passengers traveling scheduled flights with tickets at reduced prices has changed from 60.5% in 1985 to 70.9% in 1995.¹¹⁶ Taking into account that the share of the charter market accounts for approximately 50% to 55% of the total market, it is estimated that today 85% to 90% of the passengers travel at reduced prices.¹¹⁷ In summary, the essential effects of E.U. airline deregulation are flexible airfares and additional routes within Europe.

A. Obstacles to Liberalization

Despite the ensuing liberalization, there are still a number of factors preventing the air transport market in Europe from achieving its full potential.¹¹⁸ First and foremost, intensified competition in the E.U. is in conflict with the dominance of partly state owned national carriers in almost every member state.¹¹⁹ Due to the state ownership of the national carrier, member states, particularly during the early phase of liberalization, were not willing to implement the liberalization measures and employed tactics such as delaying granting licenses to other non-state owned airlines.¹²⁰ Furthermore, the national airline has tax advantages, privileged access to landing slots at airports and sometimes partakes in the airport's allocation of slots to competitors.¹²¹ Therefore, airlines do not compete at equal levels in the deregulated European market; and unless this distortion of competition can be overcome, airlines will maintain their territorial share of the European market pursuant to former national markets.¹²²

¹¹⁶ Impact of the Third Package of Air Transport Liberalization Measures, *supra* note 112, at ii. However, these seats are often accompanied by restrictions with regards to schedule flexibility and are available only for a limited number of seats.

¹¹⁷ Nevertheless, airfares for cross-border flights tend to be still higher than domestic airfares on comparable distances, Polley, *supra* note 92, at 176.

¹¹⁸ Commission of the European Communities, *supra* note 106, at 22.

¹¹⁹ Member states which still owned more than 50 percent of the equity stock of their national carriers in 1995 were Greece (100 percent of Olympic), France (98.6 percent of Air France), Italy (86.4 percent of Alitalia), Ireland (100 percent of Air Lingus), Spain (99.8 percent of Iberia), Portugal (100 percent of Air Portugal) and Germany (51.4 percent of Lufthansa), DIETER ROGALLA & KATRIN SCHWEREN, *DER LUFTVERKEHR IN DER EUROPÄISCHEN UNION (AIRTRANSPORT IN THE EUROPEAN UNION)* 35 (1994).

¹²⁰ Polley, *supra* note 92, at 179.

¹²¹ While most airports are state owned, the national airline may also have a monopoly on the check-in and check-out procedures for passengers, the transportation and distribution of luggage, the towing and maintenance of aircraft, supplies and forwarding services. Basedow, *supra* note 17, at 264.

¹²² *Id.*; see also Loyola de Palacio, Deputy President of the European Commission, in *Bruselas Insiste en las Fusions Entre las Aerolineas Europeas [Brussels Insists on Need for Mergers Between European Airlines]*, EXPANSION, October 19, 2001 at 4 (insisting that European airlines must embark on a consolidation process in order to be competitive with U.S. airlines).

Apart from the scarcity of resources, there is no legal ground for the transfer of national carriers to the private sector because the E.U. law itself does not contain a legal obligation for member states to privatize public undertakings.¹²³ Nevertheless, there might be a possibility for the Commission to promote transfers to the private sector under the authority of Article 86(3) of the EC Treaty.¹²⁴ According to the Court of Justice, the separation of regulatory functions and commercial activities is necessary in order to guarantee the parity of treatment for private competitors of public undertakings.¹²⁵ The court's decision could furnish the legal basis for the efforts of the Commission to prevent national carriers from being granted privileges by their regulatory authorities.¹²⁶ Insofar as national airlines will lose these privileges, their competitive advantage will be diminished and, consequently, their public owners will transfer airline operations to the private sector.¹²⁷

Another obstacle to liberalization is the continued practice of state grants of aid to airlines in the E.U.¹²⁸ Under Article 92 of the EC Treaty, aid which is granted by a member state and distorts competition is incompatible with the theory of the common market insofar as it affects trade between member states.¹²⁹ In its state aid decisions, the Commission has tried to impose conditions on granting state aid to ensure that state aid is used for restructuring instead of being used for gaining a competitive advantage.¹³⁰

¹²³ To the contrary, Article 295 of the EC TREATY provides that "this treaty shall in no way prejudice the rules in Member States governing the system of property ownership".

¹²⁴ Under Article 86(3) of the EC TREATY, the Commission acting on its own and without consultation with, or approval by the Council, is not only entitled to make decisions in single cases, but it may also address directives to member states.

¹²⁵ In *French Republic v. E.C. Commission*, 1991 E.C.R. 1223,5 C.M.L.R.552, the Court of Justice rejected the member states' plaintiffs' attack on the Commission's repeal of national postal monopolies for the import and service of telecommunication terminal equipment, and separate organization of commercial and regulatory functions of postal undertakings.

¹²⁶ Polley, *supra* note 92, at 178 (claiming that many airlines "have a close relationship to the regulatory authorities").

¹²⁷ Basedow, *supra* note 17, at 264.

¹²⁸ Airlines that have received state aid since 1991 include Air France (3.15 billion Euro); Iberia (1.4 billion Euro); Olympic Airways (1.1 billion Euro); Air Portugal (0.55 billion Euro); and Air Lingus (0.25 billion Euro). NEUE ZÜRCHER ZEITUNG [NEW ZURICH NEWSPAPER], February 11, 1995, *quoted in* Rogalla & Schweren, *supra* note 119, at 41. For losses resulting from the four-day closure of American airspace after the September 11, 2001 terrorist attack, the European Commission announced that E.U. governments would be allowed to grant limited compensatory aid to airlines. *EC Authorizes Limited Airline Aid*, AVIATION DAILY, October 11, 2001, Vol. 246, No.8, at 1.

¹²⁹ Basedow, *supra* note 17, at 265.

¹³⁰ Polley, *supra* note 92, at 179. The Commission requires that the beneficiaries of cost reductions ensure that these privileges are necessary for the airline to operate profitably, that the recipient makes commitments not to expand their fleets, which means that the aid is not used to acquire other airlines or act as a price leader in airfares and that the individual governments will not grant further aid during the restructuring plan.

Compliance with the Commission's conditions, however, is difficult to supervise, and from a competition law perspective, it would be best if no state aid were granted at all.¹³¹

One of the most significant obstacles to successful liberalization is airport congestion resulting in slot allocation problems, because the absence of attractive slots is the main barrier to entry for competitors on high-density routes.¹³² Since national carriers own all the attractive slots and have superior access to airport facilities, they have a competitive advantage under the current structure.¹³³ *Council Regulation No. 95/93* preserves grandfather rights if the carrier concerned uses at least 80% of the slots during a season and permits slot exchanges between carriers on different routes at coordinated airports.¹³⁴ Only withdrawn and newly created slots are put into a pool, of which 50 percent are allocated to new entrants.¹³⁵ Empirical studies on *Regulation No. 95/93* have come to the conclusion that most slots at airports are still held by the former national carriers and that there will almost never be enough attractive slots in number and time in the pool to accommodate new entrants.¹³⁶ One proposal suggests free trading of slots is a favourable approach but the U.S. experience has shown that slots are more valuable for an incumbent airline than for a new entrant and therefore barriers of entry have increased following slot trades rather than diminished.¹³⁷ Another proposal suggests that airlines holding more than a certain percentage of slots at a fully coordinated airport could be obliged to surrender a proportion of those slots to the scheduling committee.¹³⁸ This option could generate a sufficient number of attractive slots to be available to new entrant airlines, however, it seriously affects the position of the flag carriers and might impair their ability to compete globally.¹³⁹

In summary, regulatory bias rooted in public ownership, and the infrastructure of airport congestion are the most important structural obstacles for the liberalized single aviation market.

¹³¹ *Id.*

¹³² Commission of the European Communities, *supra* note 112, at 22.

¹³³ Polley, *supra* note 92, at 179.

¹³⁴ Council Regulation 95/93, 1990 O.J. (L 14) 1 (regarding common rules for allocation of slots at Community airports).

¹³⁵ *Id.*

¹³⁶ Polley, *supra* note 92, at 180.

¹³⁷ Peter Morrell, *The Single Market Review, Impact on Services*, 13 AIR TRANSPORT 13, 14 (1997).

¹³⁸ Karel Van Miert, Competition Policy in the Air Transport Sector, Address Before the Royal Aeronautical Society (March 9, 1998), *quoted in* Polley, *supra* note 92, at 181.

¹³⁹ *Id.* (claiming that the approach of the Commission is still open, while Directorate General IV opposes trading in slots, Directorate General VII seems to advocate the trading in slots approach).

B. Commission's Power Towards Bilateral Agreements

Another serious problem for the liberalized aviation market is the continued application of bilateral air transport agreements that protect the national carriers of the contracting parties by capacity restrictions in air traffic between the E.U. member states and third countries.¹⁴⁰ Aside from their diversity, the agreements with third countries also distort competition within the E.U., since some airlines operate on protected markets while other carriers face competition.¹⁴¹ Apparently, the Commission's proposal to directly conduct negotiations with third countries¹⁴² aroused criticism from Europe's national carriers, who played an influential part in the bilateral negotiation process in the past.¹⁴³ In its *Opinion 1/94* the Court of Justice held that regardless of Article 113 of the EC Treaty,¹⁴⁴ the Community has no power, yet, for negotiation on international transport agreements with non-member states.¹⁴⁵ Nevertheless, the Court of Justice concluded that member states would lose their right to assume obligations with nonmember countries when common rules, which could be affected by those obligations, come into being.¹⁴⁶ In order to get the Commission's approval for recently concluded bilateral air transport agreements with the U.S. and to avoid further proceedings, the member states gave the Commission a mandate limited to regulatory aspects of air transport.¹⁴⁷ However, the more controversial subjects of access, traffic rights, designation and fares are to be addressed in a second phase, and the Commission will need a further mandate from the Council before it can commence negotiations on these subjects.¹⁴⁸ As a re-

¹⁴⁰ *Id.* at 178.

¹⁴¹ Commission of the European Communities, *supra* note 112, at 22.

¹⁴² Air Transport Relations with Third Countries: Communication from the Commission to the Council, COM (92) 434 final at 50.

¹⁴³ G. Porter Elliot, *Antitrust at 35,000 Feet: The Extraterritorial Application of United States and European Community Competition Law in the Air Transport Sector*, 31 GEO. WASH. J. INT'L L. & ECON. 185, 228 (1998) (noting that member states will remain reluctant to relinquish sovereignty in external air transport matters if the Commission cannot promise a minimum level of protection of their flag carriers. The risk that free competition might lead to airline bankruptcy is unacceptable to national governments).

¹⁴⁴ Article 113 of the EC Treaty confers the exclusive power for negotiation of trade agreements with nonmember states on the Community.

¹⁴⁵ Court of Justice, *Opinion 1/94*, 1 C.M.L.R. 205 (1995), on the question of Community competence in connections with agreements comprised in the GATT Uruguay Round.

¹⁴⁶ On this basis, the Court held that competence might be shared between the Community and its member states and that they therefore had a duty to cooperate; however, in the field of aviation, in which there are few areas in which the Community enjoys exclusive competence, the obligation of the member states to cooperate is limited, John Balfour, *Aviation Relations between EC Member States and Other States*, 2 EUR. FOREIGN AFF. REV. 97, 105 (1997).

¹⁴⁷ *See id.* (such as slot allocations, computer reservation systems, code-sharing, airport services, environmental standards, state aid and ownership limits).

¹⁴⁸ Mark Gerchick, Assistant Secretary at the U.S. Department of Transportation, Remarks at the Conference of the European Law Institute of the University of Trier in Frank-

sult of the refusal to delegate more negotiating powers for aviation to the Commission, U.S. carriers obtained fifth freedom rights between European points through bilateral agreements with the single member states, while European airlines cannot enjoy the equivalent rights to serve city pairs in the U.S.¹⁴⁹

VI. AIRLINES' STRATEGIC RESPONSES TO LIBERALIZATION

European aviation is part of a much larger aviation market and as such it is influenced by, but also influences, changes in the world of aviation.¹⁵⁰ The implementation of the third aviation package has increased competition and European carriers have already made major efforts to improve their competitiveness by reducing costs and increasing productivity.¹⁵¹ As size becomes an important factor in a more liberalized aviation market, European airlines have begun to seek ways of maximizing economies of scope and of density.¹⁵² Some of them have taken the classic route of direct takeovers, (for example British Airways' takeover of British Caledonian), but international air services between E.U. member states and other countries are still determined by bilateral agreements.¹⁵³

These so-called "Open Skies" agreements often require the designated national carriers to be owned and controlled by nationals of the countries involved and include prohibitions on the carriage by foreign carriers.¹⁵⁴ Whenever bilateral agreements are undermined by an acquisition, national carriers would lose advantages granted to them, for example antitrust immunity.¹⁵⁵ Consequently, airlines have attempted to strengthen their market positions by concluding partnerships, co-operative arrangements or alli-

furt (May 1996), *quoted in* Balfour, *supra* note 146, at 103 (arguing that "the U.S. considers discussions on the regulatory aspects to be unnecessary and inappropriate and would not be willing to negotiate with the E.U. unless matters of access and traffic rights were also on the table").

¹⁴⁹ *Opening Wider*, *supra* note 23, at 7 (arguing that the U.S. has picked off European markets one by one while stopping foreigners from picking up passengers at more than one American city).

¹⁵⁰ Botton & Schwan, *supra* note 2, at 118.

¹⁵¹ Karel van Miert, The transatlantic and global implications of European competition policy, Address Before the North Atlantic Assembly Meeting (February 16, 1998), *available at* http://europa.eu.int/comm/competition/speeches/text/sp1998_054_en.html.

¹⁵² Botton & Schwan, *supra* note 2, at 118.

¹⁵³ *Id.*

¹⁵⁴ Joanne W. Young, *Airline Alliances-Is Competition at the Crossroads?*, 24 AIR & SPACE L. 287, 288 (1999).

¹⁵⁵ Philippe Chappatte, The Alliance Between SAS and Lufthansa-a Model for Future Cooperation Between Airlines in Europe, Address Before the European Air Law Association Eighth Annual Conference (November 8, 1996), *quoted in* 10 EUROPEAN AIR LAW ASSOCIATION CONFERENCE PAPERS 53, 55 (1997); *see also* Polley, *supra* note 92, at 193-94.

ances.¹⁵⁶ These are mainly designed to achieve fleet rationalization, expansion and rationalization of network structure, greater exploitation of cost-side economies of scale, and reduction of costs through joint purchasing and joint marketing.¹⁵⁷

In a strategic alliance, the partners to the alliance seek to develop a single network to sell to their respective customers.¹⁵⁸ In consequence, alliances enable airlines to obtain the efficiencies and benefits normally linked with mergers and acquisitions. Today there are 580 airline alliances involving 220 airlines.¹⁵⁹ This is a startling number considering that ten years ago alliances were virtually unknown, and it has only been five years since the U.S. Department of Transportation approved the first alliance agreement with antitrust immunity for Northwest and KLM.¹⁶⁰ Although the scope and nature of these alliances differ from equity exchange, code sharing, block booking arrangements to joint marketing agreements and joint fares,¹⁶¹ there is a tendency towards deeper alliances involving co-operation on all aspects of airline business, amounting to virtual merging of alliance members' activities.¹⁶² As consolidation in the U.S. might lead to three or four main carriers,¹⁶³ it is estimated that major alliances may also result in three or four major network competitors on an international market such as U.S.-Europe.¹⁶⁴

¹⁵⁶ Jost Stragier, Current Issues Arising with Airline Alliances, Address Before the 11th Annual Conference of the European Air Law Association (November 5, 1999), available at http://europa.eu.int/comm/competition/speeches/text/sp1999678_en.html.

¹⁵⁷ *Id.*

¹⁵⁸ Chapatte, *supra* note 155, at 54 (claiming that strategic alliances usually involve route and schedule coordination and planning, code-sharing, joint fare planning and budgeting, reciprocal frequent flyer arrangements, joint marketing, advertising, and distribution and sales of the alliance routes).

¹⁵⁹ *Huddling together, A Survey of Air Travel*, ECONOMIST, March 10, 2001, at 8.

¹⁶⁰ Young, *supra* note 154, at 287.

¹⁶¹ Trevor French, *Global trend in Airline Alliances*, 4 TRAVEL & TOURISM ANALYST, 81, 83-86 (1997).

¹⁶² Van Miert, *supra* note 151 (noting that "the four transatlantic alliances establish an even closer co-operation by consulting each other on commercial aspects of their business like prices, capacities, frequencies, schedules, common purchases, relations with travel agents, ground handling and Frequent Flyer Programs").

¹⁶³ *Fixing America's Airlines*, *supra* note 54, at 21 (arguing that the United Airlines take over of US Airways and the American Airlines take over of TWA would put pressure on Delta Airlines to merge with Continental so that three mega-carriers would dominate the market).

¹⁶⁴ *Let fly, A Survey of Air Travel*, ECONOMIST, March 10, 2001 at 14 (claiming that the number of major alliances will be as many as there are large U.S. partners, which guarantees a footing in the U.S. because a foreign airline cannot get around the Jones Act that limits foreigners to owning 25 percent of voting shares in an U.S. airline); see also Young, *supra* note 153, at 289 (noting that Oneworld's most important partner British Airways and KLM/Northwest have already announced their intentions to form competitive global alliances).

Table 4: Global Market Share of World Air Traffic in June 2000¹⁶⁵

International Airline Alliance	Most Important Partner of Alliance	Percentage of Total Revenue Passenger Kilometers of Alliance
Star Alliance	United Airlines, Lufthansa, Singapore Airlines	21.3 %
Oneworld	British Airways, American Airlines, Cathay Pacific, Iberia	16.4 %
Skyteam	Air France, Delta Airlines, Continental	9.5 %
Wings	KLM, Northwest	6.4 %
Other	Other airlines (partly partner in smaller alliances)	46.5 %

Airline alliances therefore raise fundamental questions about their effect on competition in air services.¹⁶⁶ The effect on competition of airline alliances depends upon the nature of the allied networks, in particular, an alliance can significantly reduce competition on overlapping non-stop routes and overlapping connecting routes where the allied airlines were once main competitors.¹⁶⁷ Moreover, "alliances between airlines operating hub-and-spoke networks will normally enhance demand for the network" as a whole and increase the market power of the network, which entails the risk of rendering still more difficult new entry into the network's markets.¹⁶⁸

In summary, multiple connecting options by airline alliances clearly benefit many consumers, however, there is credible evidence to suggest that some major alliances may have anticompetitive effects in certain markets. Given a real potential for amalgamation of airlines into a few mega-airlines,

¹⁶⁵ *Huddling together*, *supra* note 159, at 8; see also Jean-Francois Le Grand, Aviation Civile Et Transport Aérien [Civil Aviation and Air Transport], Avis présenté au nom de la Commission des Affaires économiques de l'Assemblée Nationale [Memorandum presented on behalf of the Commission on Economic Affairs of [French] Parliament, SÉNAT NO 87, November 20, 1997, at 21 (estimating the global market share of possible future Airline Alliances).

¹⁶⁶ See Vagn Sørensen (Senior Vice President of SAS), *The Alliance between SAS and Lufthansa: A model for future cooperation between airlines in Europe*, 10 EUROPEAN AIR LAW ASSOCIATION CONFERENCE PAPERS, 48, 50 (1997) (contesting that "it was considered a basic requirement that the routes of the two carriers [SAS and Lufthansa] between Scandinavia and Germany be coordinated to eliminate the earlier competitive element").

¹⁶⁷ See Stragier, *supra* note 156, at 1 (arguing that even where the two networks do not overlap in the markets they serve, the alliance can have serious anti-competitive effects by reducing or eliminating competition on the hub-to-hub route(s) between the networks).

¹⁶⁸ *Id.*

it is reasonable to ask how the U.S. government and the European Commission have responded to these competitive concerns.

A. U.S. Antitrust Enforcement

“Viewing the competitive landscape it appears that two of the most significant impediments to competition in the age of alliances is the power of the alliance partners to exclude other carriers from entering markets because of pre-existing barriers or barriers created by the alliance itself.”¹⁶⁹ Under U.S. antitrust law, depending on the scope of entry barriers, a market share of 50% or more could be the basis for a finding of attempted monopolization, and a market share of 75% is considered sufficient to find monopoly power.¹⁷⁰ Nevertheless, “U.S. antitrust enforcement in recent years has largely focused on efficiency issues and the benefits to be derived from carrier coordination.”¹⁷¹ Thus, until the order in December 1997 on the American/TACA alliance, the U.S. Department on Transportation¹⁷² had imposed very few restrictions on alliances and allowed participants in most cases to consolidate operations and coordinate fares even in point-to-point markets where no other direct competition existed.¹⁷³ As far as international airline alliances are concerned, the “U.S. takes the position that it has antitrust jurisdiction over foreign activity that has a substantial effect on U.S. commerce even if the challenged conduct occurs entirely outside the U.S.”¹⁷⁴ In consequence, collaborative management techniques of international alliances that might be forbidden under U.S. antitrust law must be granted immunity from antitrust prosecution if they are to proceed.¹⁷⁵ “Such immunity serves to partially override the substantial inefficiencies of the existing bilateral aviation system, and to allow airlines to link their operations closely so that they can develop virtual global aviation systems.”¹⁷⁶

¹⁶⁹ Young, *supra* note 154, at 292.

¹⁷⁰ See *U.S. v. American Airlines*, 743 F.2d 1114 (5th cir. 1984) in which the court held that a joint market share of 76 percent of the monthly enplanements at Dallas would be sufficient to create a monopoly.

¹⁷¹ Young, *supra* note 154, at 291 (noting that the U.S. has generally adopted the view that competition over gateways by various alliances would promote or at least maintain competition).

¹⁷² The U.S. Departments of Transportation and Justice are jointly responsible for policing competition in air transport. French, *supra* note 161, at 99.

¹⁷³ In the American/TACA order, which was issued on 31 December 1997, the U.S. Department of Transport expressed its concern about the potential new entry in the small Central American markets dominated by American and its proposed Alliance partners and imposed principal restrictions on the marketing coordination and the exclusivity clause that would prevent the TACA carriers from also entering into alliances with other U.S. carriers. Young, *supra* note 154, at 291.

¹⁷⁴ *Id.*

¹⁷⁵ French, *supra* note 161, at 100.

¹⁷⁶ Charles A Hunnicutt, *Aviation Liberalization: a U.S. View*, 28 INT’L BUS. LAWYER 58, 60 (2000).

Therefore, antitrust immunity has become the U.S.'s major bargaining chip in securing liberal "open skies" bilateral agreements, particularly in Europe.¹⁷⁷ However, the United States has granted antitrust immunity only after finding that a proposed alliance would be pro-competitive, pro-consumer and consistent with U.S. aviation objectives.¹⁷⁸

B. Application of E.U. Competition Rules to Air Transport

The wave of alliances between airlines operating across the Atlantic has led to a number of important competition investigations. "Since these alliances affect E.U. markets for air transport, the Commission has an obligation to ensure that they comply with the competition rules set out in Articles 81 and 82 of the EC Treaty."¹⁷⁹ The role of the E.U. competition rules in the aviation sector is to prevent regulatory barriers from being replaced by anticompetitive agreements (such as market sharing, price fixing etc.) between airlines, or abusive behavior by a dominant carrier, which could significantly reduce or eliminate the benefits of liberalization.¹⁸⁰

The E.U. takes a different view of competition analysis than the U.S. authorities even though the underlying laws, Articles 81 and 82 of the EC Treaty and Section 1 and 2 of the Sherman Act, are similar.¹⁸¹ "Thus, while the U.S. generally sees efficiencies resulting from an alliance as a benefit, the E.U. tends to see efficiencies as a potential abuse of a dominant position and takes a more protectionist attitude towards new entrants."¹⁸²

Regarding the application of Articles 81 and 82 of the EC Treaty to air transport within the E.U., the European Commission¹⁸³ can now fully implement the competition rules in the deregulated aviation market.¹⁸⁴ This contrasts with air transport between the E.U. and third countries, where the

¹⁷⁷ See *id.* The Netherlands, Austria, Belgium, Germany and Switzerland signed open skies bilaterals in return for alliance anti-trust immunity.

¹⁷⁸ *Id.*

¹⁷⁹ Stragier, *supra* note 156.

¹⁸⁰ J.F. Pons, address before the Chicago Beyond Open Skies Conference, December 5-7, 1999, available at http://europa.eu.int/comm/competition/speeches/text/sp1999679_en.html.

¹⁸¹ In general Article 81 (1) of the EC TREATY aims to prohibit "arms length" competitors from agreeing between themselves to prevent, restrain, or distort competition and is roughly analogous to the prohibition against restraints of trade in Section 1 of the U.S. Sherman Act. See Treaty Establishing European Community 37 I.C.M. 79 (1998) entered into force May 1, 1999; Article 82 of the EC Treaty prohibits dominant position to the prejudice of competitors or consumers and is more encompassing than monopolization as offense under Section 2 of the Sherman Act. See also FOLSOM, GORDON & SPANOGLE, *supra* note 4, at 321.

¹⁸² Accordingly, the European Commission is apparently concerned about the impact of combined frequent flyer programs and CRS displays of code sharing flights. See Young, *supra* note 154, at 291.

¹⁸³ FOLSOM, WALLACE GORDON & SPANOGLE, *supra* note 4, at 322 (noting that the terms of Articles 81 and 82 of the EC TREATY are enforced, in the first instance, by the European Commission).

¹⁸⁴ Pons, *supra* note 180.

Commission does not yet have the same type of investigation and enforcement powers it has in other industries to enforce these rules.¹⁸⁵ Until the Council adopts secondary legislation, the Commission can only use the residual powers granted to it by a transitional provision of the EC Treaty to ensure the application of the E.U. competition rules in cooperation with the competent authorities in the E.U. member states.¹⁸⁶ The procedures involved are cumbersome and they do not allow the Commission to enforce decisions recording an infringement of the rules, nor to grant an exemption or to impose fines upon infringing companies.¹⁸⁷ The Commission has proposed the necessary legislation to the Council of Ministers enabling the Commission to apply Articles 81 and 82 of the EC Treaty extraterritorially.¹⁸⁸ "Up to now, the Council has not yet adopted the Commission's 1997 proposals."¹⁸⁹

In summary, while international airline alliances are subject to U.S. antitrust jurisdiction, E.U. competition rules regarding aviation do not yet apply with respect to air transportation to and from third countries.

VII. CONCLUSION

Airline deregulation in the European Union has been a major step towards a fully liberalized aviation market. In consequence, Europeans benefit from many discount fares and a network of additional routes within the E.U. However, a single aviation market has not yet been accomplished because deregulation alone is not a sufficient prerequisite for intense competition. The regulatory bias rooted in public ownership is a structural problem, which can only be solved by selling the national carriers to private owners. As far as the infrastructure of airport congestion is concerned, the Commission will have to find a way to ensure that sufficient slots are available for new entrants on monopoly or duopoly routes in Europe.

¹⁸⁵ Stragier, *supra* note 156.

¹⁸⁶ Case 66/86 Ahmed Saeed Flugreisen and Silver Line Reisebüro v. Zentrale Zur Bekämpfung Unlauteren Wettbewerbs, 1989 ECR 803 (the European Court of Justice has made clear that in the air transport sector an implementing regulation has only been introduced regarding air transport between Community airports. However, this does not deprive the E.U. competition rules of all effects with regard to air transport between Community airports and non Community airports, by confirming that in such cases the Commission still has the residual powers conferred by Article 85(1) of the EC TREATY to investigate cases of suspected infringement, in cooperation with the competent authorities in the member states). See also Balfour, *supra* note 146, at 107 (noting that the Commission recently opened investigations under Article 85(1) of the EC TREATY into existing alliances between Northwest/KLM, Star Alliance and Oneworld).

¹⁸⁷ Stragier, *supra* note 156.

¹⁸⁸ See generally Commission of the European Communities, Application of the competition rules to air transport, COM(97)218 final.

¹⁸⁹ Stragier, *supra* note 156.

One central goal to be pursued by the E.U. in the next phase of liberalization must be the application of Community competition law on international airline alliances in order to ensure that these alliances do not rule out the opportunities for real competition. At the same time, cooperation between the respective antitrust authorities in the E.U. and the U.S. must be strengthened in an attempt to avoid conflicting decisions and to establish multilateral guidelines to assure uniform treatment of airline alliances. Carriers who follow these guidelines would then be able to understand what would be required to gain approval for the alliance.

Finally, as long as third countries maintain bilateral transportation agreements with each member state, they will weigh the comparative advantages of the individual bilateral agreements as an alternative entry door leading into the single European aviation market. Therefore, the competition between regulations that are contained in bilateral agreements, and their discriminatory nationality clauses, call for Community action which should lead to the transfer of negotiation power from the single member states to the Community.

